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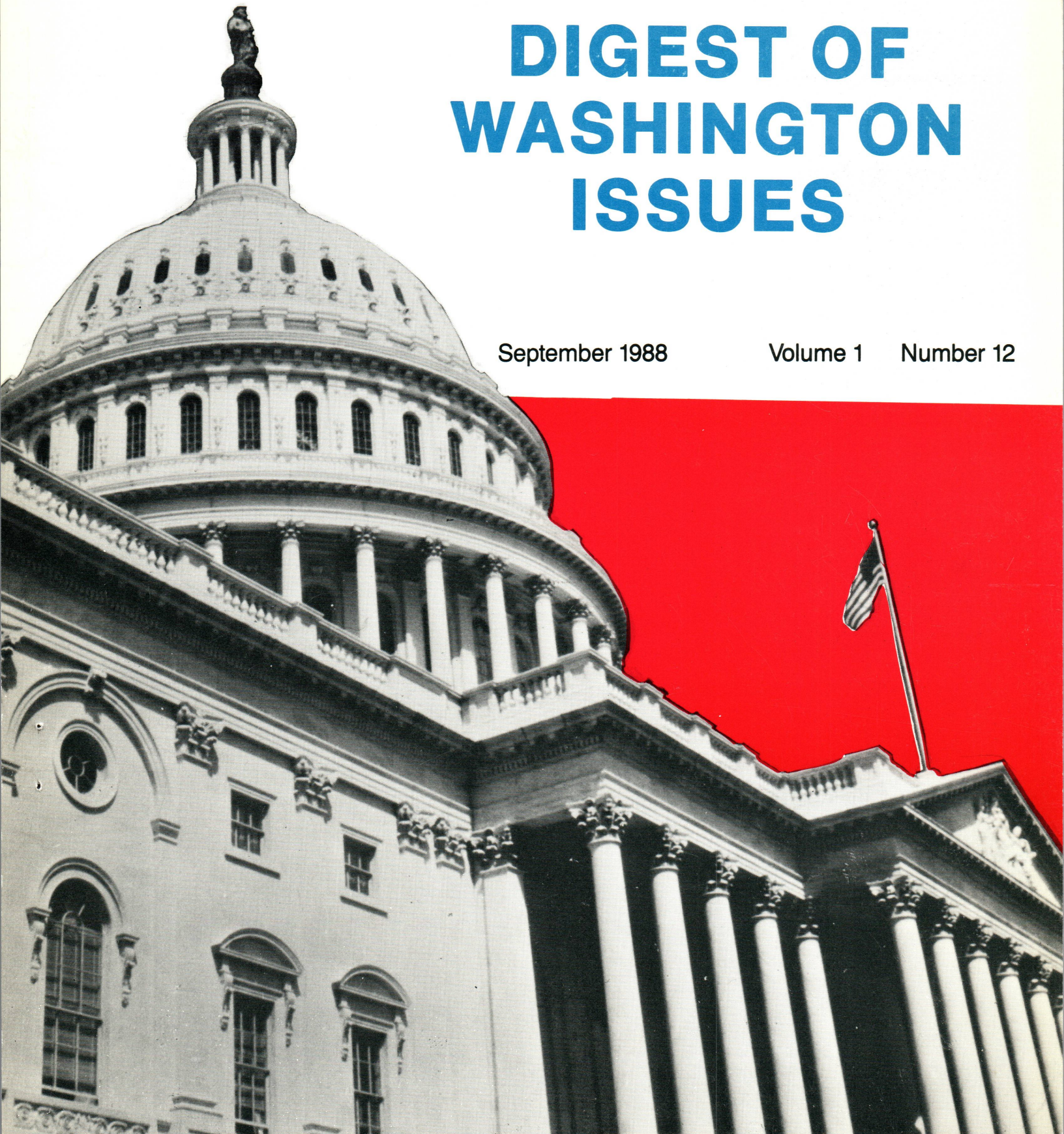

DIGEST OF WASHINGTON ISSUES

1. Possible Securities Legislation Resulting from the Treadway Commission's Recommendations 1

2. Civil RICO Reform 3

3. Technical Corrections Act of 1988 6

4. Congressional Oversight Hearings on the Accounting Profession (Dingell Hearings) 8

5. Federal Financial Management Reform Legislation 10

6. Taxpayers' Bill of Rights 12

7. Civil Tax Penalty System Reform 14

8. Congressional Hearings on the Quality of Audits of Federal Financial Assistance (Brooks Hearings) 16

9. Consultant Registration and Reform Act of 1988 (Pryor Bill) 18

10. Government Contractor Profits Information Reports . . 20

11. Various Legislative Proposals in Conflict with GAAP 23

12. Major Fraud Act of 1988 25

13. Professionals' Liability Reform Act of 1988 (Ritter Bill) 27

14. Long Term Health/Home Care Catastrophic Legislation . 28

15. The Financial Fraud Detection and Disclosure Act (The Wyden Bill) 30

16. Disclosure of Tax Return Information (Byron Bill) 32

17. Information Sheet on the AICPA 34

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POSSIBLE SECURITIES LEGISLATION RESULTING FROM THE TREADWAY COMMISSION'S RECOMMENDATIONS

ISSUE

Should Congress approve legislation to implement certain recommendations of the Treadway Commission?

AICPA POSITION

The AICPA has not taken a position on the specific Treadway Commission recommendations that may require implementing legislation at this time.

BACKGROUND

In its final report the National Commission on Fraudulent Financial Reporting (The Treadway Commission) made several recommendations which may require amending our nation's securities laws. The Treadway Commission recommended expanding the SEC's enforcement authority to enable the agency to:

- bar or suspend officers and directors of publicly held corporations,
- mandate audit committees composed of independent directors for all publicly held corporations,
- seek civil money penalties in injunctive proceedings,
- issue cease and desist orders when it finds a securities law violation, and
- impose civil money penalties in administrative proceedings including Rule 2(e).

In November 1987, Representative John Dingell (D-MI), Chairman of the Subcommittee on Oversight and Investigations of the House Energy and Commerce Committee, addressed the Corporate Accounting and Financial Reporting Institute. In his comments Rep. Dingell suggested that some of the recommendations of the Treadway Commission be implemented in legislation. Rep. Dingell remarked that "Congress has a responsibility to move forward on the good ideas of the Treadway Commission that will require legislation." Rep. Dingell has asked his staff "to identify specific proposals for change that should be included in potential legislation."

In February 1988, Rep. Dingell requested the SEC to comment on the Treadway Commission recommendations asking whether the SEC has the authority to implement the Treadway recommendations by rule or regulation or whether legislation is needed. The SEC responded to Rep. Dingell's request in April 1988.

In May 1988, SEC Chairman David Ruder testified before the Dingell subcommittee on the recommendations of the Treadway Commission. In his opening statement, the SEC Chairman stated the Commission has taken, or is in the process of taking, action in response to certain of the recommendations, such as those relating to opinion shopping and peer review. The SEC Chairman also testified that the Commission has determined to request legislation which will enhance the Commission's enforcement authority, including imposing civil money penalties, barring or suspending persons from serving as officers and directors and expanding cease and desist orders.

RECENT DEVELOPMENTS

None

JURISDICTION

SENATE - Committee on Banking, Housing and Urban Affairs

Securities Subcommittee

HOUSE - Committee on Energy and Commerce

Telecommunications and Finance Subcommittee

RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

ISSUE

Should the civil provisions of the RICO statute be amended?

AICPA POSITION

The AICPA supports **H.R. 4923**, new legislation introduced by Representative Rick Boucher (D-VA) on **June 28, 1988.** The AICPA also supports the **amended version of S. 1523**, approved by the Senate Committee on the Judiciary on May 24, 1988.

BACKGROUND

RICO is one part of the 1970 Organized Crime Control Act. Congress authorized private persons victimized by a "pattern" of "racketeering activity" to sue for treble damages and attorneys' fees. In describing the kinds of "racketeering activity" that could give rise to such lawsuits, however, Congress included not only murder, arson, extortion, kidnaping, and drug trafficking, but also mail fraud, wire fraud, and fraud in the sale of securities.

Instead of being used as a weapon against organized crime, private civil RICO has become a regular feature of ordinary commercial litigation. RICO cases growing out of securities offerings, corporate failures, and investment disappointments have become almost routine. Many of these cases have included accountants as co-defendants who are charged with participating in an alleged "pattern of racketeering activity."

Early in the 99th Congress, the AICPA decided to take the lead in convincing Congress to cure these abuses. It brought together a coalition representing the securities industry, the life insurance and property and casualty insurance industries, banks and major manufacturers and their trade associations. In addition, the coalition worked together with representatives of major labor unions, led by the AFL-CIO, that also supported major reforms of civil RICO to prevent its growing abuse.

The principal sponsor in the House of the AICPA's preferred solution to the RICO problem was Rep. Boucher. In July 1985, he introduced a bill that would have limited civil RICO suits to cases in which the defendant had been convicted of a criminal act.

While the Boucher bill garnered widespread support in Congress, consumer groups strongly opposed the legislation and were able to enlist key Chairmen to block the bill's progress. The coalition negotiated a compromise proposal that would have reduced RICO's treble-damage provision to single damages in certain cases.

The AICPA and other groups supported this compromise because it was a substantial improvement over current law. The compromise bill passed the House by a vote of 371 to 28 on October 7, 1986, but failed in the Senate by two votes.

In the wake of the insider trading scandals that rocked Wall Street in November 1986, some opposition to an important provision in our compromise bill arose in Congress and among certain elements of the consumer groups. The provision we support would eliminate multiple damages in RICO suits based on transactions subject to federal or state securities laws. That provision would apply to most cases in which accountants and accounting firms are defendants.

Along with the securities industry, we agreed to a modification of that provision so that a plaintiff could still seek multiple damages in a suit arising from insider trading. Rep. Boucher found this compromise satisfactory, and introduced H.R. 2983 in July 1987, legislation similar to the bill passed by the House with this modification.

Senator Metzenbaum, who has taken responsibility for RICO reform legislation in the Senate, was not satisfied with Rep. Boucher's legislation, i.e. allowing multiple damages in a suit arising from insider trading. We negotiated for months in early 1987 with him and his staff, seeking a formulation that would allow for multiple damages in insider trading circumstances while still providing real relief for RICO defendants. Those negotiations were unsuccessful; Senator Metzenbaum eventually broke them off and introduced a bill in July 1987 that was wholly unacceptable to us.

Under Senator Metzenbaum's original bill, a large group of plaintiffs--called "small investors"--would have been allowed to seek multiple damages even if their RICO claim arose from a securities-related transaction. Every RICO securities class action that is brought under current law could have been brought under the Metzenbaum formulation.

In fact, the original Metzenbaum proposal was worse than current law for the accounting profession and other defendants in securities litigation. Today, many courts find ways to dismiss RICO claims in securities-related cases because they believe that Congress did not intend for the statute to be used that way. If Senator Metzenbaum's original proposal was enacted into law, then that judicial hostility would disappear, plaintiffs would be more willing to assert RICO claims, and courts would be less willing to dismiss them.

In October 1987, the Senate Judiciary Committee held a hearing, chaired by Senator Metzenbaum, on RICO reform. Representatives from the AICPA along with the Department of Justice, National Association of Attorneys General, National Association of Manufacturers, Securities Industry Association and the AFL-CIO testified at the hearing.

The "small investor" provision of the Metzenbaum legislation, which the AICPA strenuously opposed, was deleted during a Senate Judiciary Committee markup. The AICPA now supports S. 1523, as amended.

RECENT DEVELOPMENTS

In June 1988, Rep. Boucher introduced H.R. 4923, civil RICO reform legislation. H.R. 4923 is an identical companion to S. 1523, as amended. The bill has been referred to the House Judiciary Criminal Justice Subcommittee which held a hearing on the measure in August.

The Senate Judiciary Committee has issued its report on S. 1523; it is Committee Report 100-459. Now that the Committee Report has been filed, S. 1523 is ready for consideration and debate by the Senate.

POSITION OF OTHERS

There is widespread support in the business community for amending civil RICO and for the Boucher bill and S. 1523, as amended by the Senate Judiciary Committee.

JURISDICTION

SENATE - Committee on the Judiciary

HOUSE - Committee on the Judiciary

THE TECHNICAL CORRECTIONS ACT OF 1988

ISSUE

Should Congress approve Technical Corrections legislation to make changes to the 1986 and 1987 tax acts?

AICPA POSITION

In February 1988, the AICPA Tax Division designated Technical Corrections legislation as its primary legislative priority. However, the Technical Corrections bill which was introduced in March 1988, includes a provision that the Institute is actively opposing. Specifically, this provision removes the taxable income limitation in determining the built-in gains tax for C corporations that make S elections after March 31, 1988.

The AICPA prefers legislation passed by the House of Representatives that allows untaxed built-in gains to be carried forward for ten years. The gains will be taxed only when the entity has taxable income.

The Senate Finance Committee version of Technical Corrections provides relief for a limited group of taxpayers (primarily cash method personal service corporations). It does not address the wherewithal-to-pay dilemma faced by a diverse group of other taxpayers such as family farm corporations, manufacturers and retailers. The Institute is urging the Senate Finance Committee to accept the House Ways and Means Committee wording in section 106(f) of H.R. 4333.

BACKGROUND

On March 31, 1988 Representative Dan Rostenkowski (D-IL), Chairman of the House Committee on Ways and Means, introduced H.R. 4333, "The Technical Corrections Act of 1988." On the same day Senator Lloyd Bentsen (D-TX), Chairman of the Senate Committee on Finance, introduced an identical Technical Corrections bill, S. 2238.

Of concern to the AICPA is a provision that will radically change the computation of the built-in gains tax for C corporations that make S elections after March 31, 1988. Under the proposed correction, electing entities will no longer be allowed to limit their built-in gains tax to corporate taxable income. Electing entities will only be allowed to offset built-in gains with built-in losses.

If these corrections are enacted, many electing entities will be assessed built-in gains tax without any ability to pay. For example, since unrealized accounts receivable are considered built-in gains assets, their collection will trigger built-in

gains tax, even if the collection proceeds were used to meet business obligations. Therefore, a tax liability exists in situations where no cash is available.

RECENT DEVELOPMENTS

In recognition of the wherewithal-to-pay problem, both the House Ways and Means Committee and the Senate Finance Committee have made modifications to the legislation as originally introduced.

The House addressed this problem by stating that it was appropriate not to impose the built-in gains tax in a year that the taxpayer had experienced losses. The Committee adopted modified language stating that any recognized built-in gains not subject to the tax due to the net income limitation will be carried forward. These suspended gains will be subject to tax to the extent that the entity has taxable income within the ten year statutory recognition period.

The Senate Committee on Finance expanded the definition of built-in losses to include those recognition period deductions that were attributable to pre S-periods. This change would be helpful to those electing entities that have potential deductions on the date of the election, but which have not been accrued due to the entities' method of accounting.

JURISDICTION

SENATE - Committee on Finance

HOUSE - Committee on Ways and Means

CONGRESSIONAL OVERSIGHT HEARINGS ON THE ACCOUNTING PROFESSION (DINGELL HEARINGS)

ISSUE

Are independent auditors fulfilling their responsibilities relative to audits of publicly owned corporations?

AICPA POSITION

Independent auditors are fulfilling those responsibilities and the profession has taken a number of steps to enhance the effectiveness of independent audits. These include:

- Strengthening audit quality by expanding the scope and requirements for peer review conducted under the supervision of the Institute's SEC Practice Section and the Public Oversight Board.
- Revising auditing standards on internal control, fraud and illegal acts, auditors' communications and other "expectation gap issues."
- Creating the National Commission on Fraudulent Financial Reporting, chaired by former SEC Commissioner James C. Treadway.
- Recommending to the SEC expanded disclosure requirements when an auditor resigns from an audit engagement, particularly when there are questions about management's integrity.

BACKGROUND

In February 1985, under the chairmanship of Representative John Dingell (D-MI), the Subcommittee on Oversight and Investigations of the House Energy and Commerce Committee began hearings on the accounting profession. The hearings focused on the effectiveness of independent accountants who audit publicly owned corporations and the performance of the SEC in meeting its responsibilities. In all, 17 day-long sessions were held between 1985 and 1986, and over 100 witnesses testified. There were no hearings held on this issue in the U.S. Senate during 1985-1986.

Six hearings have been held during the 100th Congress. Three hearings held in July 1987 focused on the recommendations of the National Commission on Fraudulent Financial Reporting (Treadway Commission). Witnesses at the first hearing were the members of the Treadway Commission. At the two following hearings, representatives of all the organizations sponsoring the Treadway Commission testified, including the AICPA.

The Dingell Oversight Subcommittee has held two hearings regarding the failure of ZZZZ Best Co., a California carpet cleaning and building restoration concern, which declared bankruptcy in July 1987. The 8K reporting process was a focus of the hearings.

In April 1988, in a transmittal letter to the members of the House Energy and Commerce Oversight Investigations Subcommittee for Committee Report 100-V, entitled "SEC Response to the Treadway Commission Report," Chairman Dingell commended the accounting profession for adopting nine new expectation gap SASs and for sponsoring the Treadway Commission. He also stated the subcommittee is working on a legislative resolution of some of the points raised in the Treadway Commission report and the SEC response.

In May 1988, SEC chairman David Ruder testified before the Dingell subcommittee regarding the recommendations of the Treadway Commission. (See Digest article entitled, "Possible Securities Legislation Resulting From The Treadway Commission's Recommendations.") In his opening statement Rep. Dingell stated, "The key to implementing necessary reforms is responsible leadership by the people and organizations with authority to require that proper standards and procedures will be followed by every company that wants to solicit money from public investors. The accounting profession--through the AICPA--has made substantial improvements in their audit standards to meet the Treadway Commission's recommendations. Their decisive and timely action, as well as their willingness to work with the subcommittee on further improvements, is commendable."

RECENT DEVELOPMENTS

None

JURISDICTION

SENATE - Committee on Banking, Housing, and Urban Affairs

Securities Subcommittee

HOUSE - Committee on Energy and Commerce

Oversight and Investigations Subcommittee

FEDERAL FINANCIAL MANAGEMENT REFORM LEGISLATION

ISSUE

Should Congress approve legislation aimed at improving federal financial management?

AICPA POSITION

The AICPA is concerned about the federal government's lack of effective financial management systems and accountability and it urges the Congress and the President to work together to improve this situation.

BACKGROUND

In March 1988, a letter from AICPA Chairman A. Marvin Strait and President Philip B. Chenok was sent to the President and Vice President, to every Member of Congress, to cabinet secretaries and to agency heads expressing the AICPA's concern about the federal government's lack of effective financial management systems and accountability, urging the Congress and the President to work together to correct this situation, and offering the accounting profession's support and assistance.

Their letter urged that steps should be taken, administratively and legislatively, to ensure implementation of the following elements:

- A uniform body of accounting and reporting standards for the federal government to be used by all departments and offices;

- A chief financial officer (CFO) for the federal government who would implement a requirement for government-wide accounting and reporting and who would be responsible for the preparation of meaningful and useful financial reports and information for the federal government;

- A CFO for each executive department and agency who would be responsible for the department or agency's accounting and reporting, including the related systems; and

- A program of audit to provide annually to the Congress, the President, and the American people an independent opinion on the financial position of the federal government and the results of its operations.

The AICPA formed the Task Force on Improving Federal Financial Management to develop a program and strategy to assist the Congress and the Administration in improving federal financial management.

RECENT DEVELOPMENTS

The General Accounting Office (GAO) recently issued a report which provides an assessment of the Office of Management and Budget's CFO's progress in addressing government financial management problems. In addition to the governmentwide level, the CFO concept should be applied at the department and executive agency levels as well, the report states. According to the report, a CFO should develop and oversee implementation of a governmentwide plan to modernize the government's financial management systems and operations. Two specific areas considered by the GAO to be especially important in achieving this objective are improving financial reporting and requiring financial statements and annual financial audits.

In August 1988, representatives from the AICPA's Task Force on Improving Federal Financial Management testified before the Task Force on Federal Budgeting and Financial Management of the House Republican Research Committee and the Republican Platform Committee on the following topics:

- **Cash Basis System - The AICPA believes that all federal agencies should follow uniform accounting principles in the preparation of their financial statements. The federal government is involved in many types of financial transactions which are unique to the federal government and not specifically addressed by the FASB or GASB.**

- **Financial management organization - The office of the Chief Financial Officer should be established legislatively. There is a need for controllers in all federal departments and agencies.**

- **Accounting and reporting systems - Unless major changes are made in the current approach to recruiting and retaining personnel, there will not be sufficient qualified financial management people to manage and operate the systems or use the information.**

The House Government Operations Committee has indicated it will hold hearings on improving federal financial management in September 1988.

POSITION OF OTHERS

The GAO, the National Association of State Auditors, Comptrollers and Treasurers, and the Association of Government Accountants generally support legislation to improve federal financial management.

JURISDICTION

SENATE - Committee on Governmental Affairs

HOUSE - Committee on Government Operations

TAXPAYER BILL OF RIGHTS LEGISLATION

ISSUE

Should the Congress approve the Taxpayer Bill of Rights legislation?

AICPA POSITION

The AICPA supports the legislation approved by the Senate Finance Committee, S. 2223, in March 1988 to promote and protect taxpayers' rights. Following approval of the measure by the Finance Committee, the AICPA Tax Division Executive Committee voted to endorse the legislation.

BACKGROUND

AICPA Chairman of the Board A. Marvin Strait and President Philip B. Chenok wrote to all United States Senators urging their support of taxpayer rights legislation. Their letter said the "proposal would provide a better balance between the rights of taxpayers and the authority of the IRS in the administration of our self-assessment system."

Key provisions of S. 2223 are as follows:

Taxpayer Contacts

- The IRS is required to provide the taxpayer with a statement describing the rights and obligations of the taxpayer and the procedures for appeal, refund claims, and collection.

- The IRS is required to more fully describe in its notices the basis for assessments of tax due, deficiencies, and penalties.

Examination Procedures

- The IRS is required to issue regulations to identify what constitutes a reasonable time and place for the scheduling of taxpayer interviews and examinations.

- During taxpayer interviews, the taxpayer need not be present if represented by a CPA or other qualified representative.

- During taxpayer interviews, the taxpayer is permitted to suspend the interview at any time if the taxpayer wishes to consult with a CPA or other qualified representative.

Reimbursement of Costs

- Taxpayers are permitted to recover professional fees and other expenses incurred in administrative proceedings as well as in litigation when the IRS takes a position that it cannot prove is substantially justified.

- Taxpayers are permitted to recover actual damages, plus reasonable litigation costs where an IRS employee carelessly, recklessly, or intentionally disregards any law or regulation.

IRS Administrative Changes

- The IRS is prohibited from using records of tax enforcement results to impose production quotas on, or to evaluate its employees.

- An "Office for Taxpayers' Services" is established and is to be headed by an Assistant Commissioner for Taxpayer Service.

In the House, Representative Ronnie Flippo (D-AL) has introduced taxpayer rights legislation, H.R. 3470.

RECENT DEVELOPMENTS

In an effort to respond to issues addressed by the Taxpayer Bill of Rights legislation, the IRS has revised its internal procedures handbook for problem resolution officers. The revisions designate the problem resolution officer as the taxpayer's advocate, enumerate taxpayer rights and protections, and give taxpayers the right to obtain internal work papers concerning their case. The IRS expanded the powers of its problem resolution program officers to permit them to delay collections, liens, or levies against taxpayers when the officers have doubts about the tax agency's justification in taking the actions.

POSITION OF OTHERS

The IRS opposes S. 2223 on grounds that it would require IRS to move funding away from tax compliance and taxpayer service functions, and would undermine efforts to restore a cooperative attitude between tax practitioners and the IRS.

JURISDICTION

SENATE - Committee on Finance

HOUSE - Committee on Ways and Means

CIVIL TAX PENALTY SYSTEM REFORM

ISSUE

Does the civil tax penalty system of the Internal Revenue Code need to be reformed?

AICPA POSITION

The AICPA supports developing a simplified and more rational civil tax penalty structure and its Tax Division has formed a Penalty Task Force to address this issue.

BACKGROUND

Three Congressional hearings have been held on civil tax penalty reform.

The first hearing was held by the Senate Finance Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service. In his opening statement, Subcommittee Chairman David Pryor (D-AR) said, "After years of patch-work legislation in the area of penalties, it is time for Congress to review the penalty provisions of the Internal Revenue Code in their entirety and work toward creating a rational and simplified penalty system." Senator Pryor announced his intent to establish a private sector task force to assist the subcommittee in its work. Two AICPA members serve on Sen. Pryor's task force.

The second hearing was held by the House Ways and Means Subcommittee on Oversight, of which Representative J.J. Pickle (D-TX) is the Chairman.

The AICPA's testimony included the following topics:

- o appropriate role for penalties;
- o relationship of examinations and penalties in encouraging compliance;
- o severity of penalties as related to seriousness of the infraction; and
- o uniformity of administration of penalties.

The IRS testified that a group within the IRS is reviewing the structure and administration of the penalty provisions in the Internal Revenue Code. The purpose of the review is threefold:

- o to develop a set of principles from which to build a sound framework for the administration of penalties;

- o to identify existing penalties that require modification, consolidation, or repeal; and

- o to identify IRS practices and procedures that should be changed or improved to facilitate and make more equitable our administration of the penalty provisions.

The Executive Task Force for the Commissioner's Penalty Study released a discussion draft entitled, "A Philosophy of Civil Tax Penalties," in June 1988. The draft discusses the underpinnings of penalties and invites interested parties to comment on the task force's viewpoint.

The AICPA Tax Division is conducting a survey of its members. The survey will focus on the administrability of the penalty system from the tax practitioner's point of view. The report, expected to be completed in October, will focus on those preparer and taxpayer penalties identified as the most burdensome or most difficult to administer fairly and uniformly.

RECENT DEVELOPMENTS

The House Ways and Means Oversight Subcommittee conducted its second hearing on tax penalties in July, focusing on recommendations for reform of the penalty system.

A report prepared by the Penalties Task Force of the Section of Taxation of the American Bar Association was released at the hearing. The results of a recent survey undertaken for the Small Business Administration concerning penalties imposed by the IRS on employment returns were also released at the hearing.

JURISDICTION

SENATE - Committee on Finance

Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service

HOUSE - Committee on Ways and Means

Subcommittee on Oversight

CONGRESSIONAL HEARINGS ON THE QUALITY OF AUDITS OF FEDERAL FINANCIAL ASSISTANCE (BROOKS HEARINGS)

ISSUE

What can be done to improve the quality of audits of federal financial assistance performed by CPAs?

AICPA POSITION

The AICPA recognized that this is an urgent problem and, among other steps, formed a Task Force to develop ways to improve the quality of audits of governmental units. The Task Force's final report contained 25 recommendations for improving the quality of such audits.

A special Implementation Committee consisting of representatives of the AICPA and other groups with responsibility for carrying out the recommendations has been established.

Other actions that have been taken by the Institute include publication of a revised audit guide on audits of state and local governmental units, presentation of training programs throughout the country on the Single Audit Act, and expansion of the peer review program of the Division for CPA Firms to include examination of the audits of governmental units.

BACKGROUND

The Legislation and National Security Subcommittee of the House Committee on Government Operations, under the chairmanship of Representative Jack Brooks (D-TX), investigated the quality of audits of federal grants to state and local governments and to nonprofit organizations. Hearings began in November 1985. A March 1986 General Accounting Office (GAO) study found that 34 percent of the governmental audits performed by CPAs did not satisfactorily comply with applicable standards. The two biggest problems identified were insufficient audit work in testing compliance with governmental laws and regulations and in evaluating internal accounting controls over federal expenditures.

In October 1986, the Brooks Committee released a report to Congress, "Substandard CPA Audits of Federal Financial Assistance Funds: The Public Accounting Profession is Failing the Taxpayers," concluding that improvements must be made in the quality of CPA audits of federal financial assistance funds.

Rep. Brooks has concluded that there is no doubt that there are serious problems in the quality of governmental audits and "if the accountants can't solve them, somebody will." He also indicated that he plans to continue hearings to monitor improvements.

In September 1987, the GAO released the results of the third phase of its review. In reviewing a relationship between the procurement process and quality of audits that resulted, the GAO found that entities are almost three times as likely to receive an audit that meets professional standards when they have an effective procurement process. The report identified "four critical attributes" that provide a framework that should substantially improve the procedures to obtain, as well as ultimately the quality of, auditor work. These attributes are:

- o competition
- o solicitation
- o technical evaluation
- o written agreement

In June 1988, the GAO issued a report entitled, "CPA Audit Quality: A Status Report on the Accounting Profession's Enforcement Efforts." The GAO report commended the AICPA and State Boards of Accountancy enforcement efforts on referrals of CPAs who performed poor quality governmental audits. Rep. Brooks also commended the Institute for its efforts; however, he stated that he was disappointed to learn that the Institute has not disclosed all disciplinary actions taken against CPAs and would like the Institute to re-evaluate its policy on that issue.

RECENT DEVELOPMENTS

In an August 1988 letter to Rep. Brooks, A. Marvin Strait, AICPA Chairman of the Board, stated that the AICPA agrees with the need for public disclosure of all disciplinary actions taken against CPAs performing substandard work. Once a trial board has made an actual determination of a member's guilt, it is uniform practice to announce the name of the member, the letter states. However, when the Ethics Committee investigation reveals that a deviation does not violate the ethics code, corrective rather than punitive measures are taken. No publication of the member's name is made. Strait stated that these procedures, "are consistent with our overall philosophy and goal to improve the competence of the practitioner in his service to clients and the public."

POSITION OF OTHERS

The GAO, the federal Inspectors General, the State Auditors, the State Boards of Accountancy, State Societies and other organizations are all working together to develop and implement ways to improve the quality of CPA audits of federal financial assistance funds.

JURISDICTION

SENATE - Committee on Governmental Affairs

HOUSE - Committee on Government Operations

Legislation and National Security Subcommittee

CONSULTANT REGISTRATION AND REFORM ACT OF 1988 (PRYOR BILL)

ISSUE

Should Congress approve the Consultant Registration and Reform Act of 1988?

AICPA POSITION

The AICPA has not taken a formal position on legislation introduced by Senator David Pryor (D-AR).

BACKGROUND

In light of the current Pentagon procurement scandal, Congress is more vigorously scrutinizing the way the Department of Defense (DOD) conducts business with the private sector.

In August 1988, Sen. Pryor, Chairman of the Senate Governmental Affairs Federal Services, Post Office and Civil Service Subcommittee, introduced S. 2674, the "Consultant Registration and Reform Act of 1988."

S. 2674 would create a registration requirement for consultants working directly for the federal government or working for a contractor on a government related project. The legislation defines a consultant as any person or organization which is a party to a contract with the federal government that furnishes "advisory and assistant services." This includes management and professional services. Under the registration requirement, consultants must provide the following information:

- **Name and business address;**
- **A description of the services provided by the consultant;**
- **A list of all public and private clients, both foreign and domestic;**
- **A description of the services furnished to each client;**
- **A statement as to whether the consultant has ever been convicted of a felony or whether the consultant is under indictment; and**
- **A statement as to whether the consultant is currently suspended or debarred by the government.**

Also, in August 1988, Representative Charles Bennett (D-FL) introduced H.R. 5158, the "Consultant Registration and Reform Act of 1988. This measure is an identical companion to Sen. Pryor's legislation.

RECENT DEVELOPMENTS

On August 11, 1988, the Senate adopted an amendment to the Department of Defense Appropriations bill. The amendment would apply many of the prohibitions and requirements contained in the Pryor bill to all consultants who work directly for the DOD or for prime government contractors who are working on DOD projects. Since this provision was not included in the House passed Defense Appropriations bill, it will need to be clarified in Conference Committee.

JURISDICTION

Senate - Committee on Governmental Affairs

House - Committee on Government Operations

GOVERNMENT CONTRACTOR PROFITS INFORMATION REPORTS

ISSUE

Should Congress require government contractors to submit profits information reports?

AICPA POSITION

The AICPA is opposed to a specific provision in legislation introduced by Representative Charles Bennett (D-FL) and Senator William Proxmire (D-WI) which allows the federal agencies blanket access to accountants' workpapers. We believe engagement working papers are the property of the independent accountant and subject to the ethical limitations relating to the confidential relationship with clients.

The AICPA Defense Contractors Committee supports specific provisions in legislation introduced by Representative Jack Brooks (D-TX) which would establish a Federal Acquisition Regulatory Council and Cost Accounting Standards Board (CASB) within the Office of Federal Procurement Policy (OFPP).

BACKGROUND

Profits earned by government contractors, and particularly defense contractors, continue to be the focus of media attention, numerous government studies and Congressional hearings. In December 1986, at the request of House Government Operations Committee Chairman Brooks, the General Accounting Office (GAO) examined the Department of Defense's (DOD) most recent profit study of defense contractors and concluded that defense contracting actually was 35 percent more profitable than commercial manufacturing from 1970 to 1979, and 120 percent more profitable from 1980 to 1983, rather than approximately equal, as the DOD had found. The GAO recommended that Congress establish a profitability reporting program and periodic profit studies to help assure fair and reasonable profit in the negotiation of government contracts.

In August 1987, House Armed Services Committee member Rep. Bennett introduced the "Defense Contractor Profits Review Act," H.R. 3134. The Bennett bill requires contractors with $100 million in annual negotiated contracts with the Departments of Defense, Army, Air Force, Navy, the National Aeronautics and Space Administration or the Coast Guard, to submit a profits information report to the Defense Contract Audit Agency (DCAA). The profits report would be submitted four months after the contractor's annual financial reporting period ends and its reliability would be reported on by an independent certified public accountant. The information would be submitted in a manner that distinguishes between the contractor's government

contracts and commercial business. The bill grants the agency head and the DCAA "access to all papers, documents and records" of the independent CPA relating to the profits information report. The legislation requires the appropriate agency head to review the profits reports submitted to DCAA to determine if a contractor has made excessive profits on past contracts.

In the Senate, similar legislation, entitled the "Cost Accounting Standards Amendments Act of 1987," S. 852, was introduced by Senator Proxmire in March, 1987. The Proxmire bill requires that contractors having $50 million in annual government contracts submit a profits report to the Administrator of the OFPP containing information similar to that outlined in H.R. 3134. The Senate bill requires that an independent CPA "attest to the information furnished" in the profits report, and grants the OFPP head access to the independent CPA's records relating to that report. Additionally, S. 852 reestablishes the CASB within the OFPP and creates a Cost Accounting and Profits Reports Advisory Council to be headed by the Comptroller General.

In September 1987, Rep. Brooks introduced legislation entitled the "Office of Federal Procurement Policy Act Amendments of 1987," H.R. 3345. The Brooks bill contains a provision requiring the Administrator of the OFPP to conduct a study "to develop a consistent methodology which executive agencies should use for measuring the profits earned by government contractors on procurements, other than procurements where the price is based on adequate price competition or on established catalog or market prices of commercial items sold in substantial quantities to the general public." The legislation also would reestablish the CASB and place it within the OFPP and would create a Federal Acquisition Regulatory Council, also to be within the OFPP.

Unlike S. 852 and H.R. 3134, Rep. Brooks' legislation would not require defense contractors to submit a profits information report, nor would the bill require CPA attestation of contractor profit data or provide access to CPA workpapers. The House Government Operations Committee, which Rep. Brooks chairs, approved H.R. 3345 four days after introduction.

In March 1988, Senator Lawton Chiles (D-FL) introduced S. 2215, "Reauthorization of the Office of Federal Procurement Policy Act of 1988," which reauthorizes the OFPP for four years. Key provisions of this bill include the retention of the current, limited regulatory authority under which OFPP may issue regulations. S. 2215 preserves the Defense Acquisition Regulatory and Civilian Agency Acquisition Councils, and provides for a CASB to be responsible for cost allocability issues. The CASB would also function in an advisory capacity to the head of OFPP who makes the final decisions on Cost Accounting Standards (CAS) matters.

RECENT DEVELOPMENTS

In August 1988, the Senate passed S. 2215, which permanently reauthorizes the OFPP. Included was an amendment which raises the threshold for contracts subject to the CAS from $100,000 to $500,000. It also clarifies that the CAS would apply only to negotiated contracts. It is anticipated that the House will consider H.R. 3345, the companion bill before adjournment.

In July 1988, H.R. 4264, "DOD Amended Budget Authorization Act of 1989," was approved by the House and Senate. The Conference Report accompanying H.R. 4264 provided that the Secretary of Defense use the most current information on profitability developed in negotiating any contract. The report also stated that an advisory committee shall be appointed to recommend a financial analysis methodology for any return on investment study. President Reagan vetoed H.R. 4264 on August 3, 1988. However, it is likely that some version of H.R. 4264 will be attached to a Defense Appropriation measure.

In a related matter, testifying before the House Government Operations Subcommittee on Legislation and National Security, Comptroller General Charles Bowsher stated that the "CAS can be a significant aid in establishing the integrity and the credibility of cost data used by DOD and industry. Since the demise of the CASB, there has been no governmental group to amend standards when desirable, or to provide interpretations, waivers, or exemptions to the standards. The capability to perform these functions needs to be established."

POSITION OF OTHERS

The Department of Defense generally disagreed with the findings in the GAO report. Regarding GAO's recommendation of legislation to create a profitability reporting program, DOD stated there is no convincing evidence to support such a program. The Financial Executives Institute's Committee on Government Business is opposed to the Proxmire and Bennett measures as introduced. The Aerospace Industries Association supports the development of a uniform methodology for computing and reporting profit data for government contracts, yet is opposed to reporting requirements that compare profit data on government and commercial contracts.

JURISDICTION

SENATE - Committee on Governmental Affairs

HOUSE - Committee on Armed Services

Committee on Government Operations

VARIOUS LEGISLATIVE PROPOSALS IN CONFLICT WITH GAAP

ISSUE

Should the Congress legislate accounting standards that conflict with GAAP?

AICPA POSITION

The AICPA advocates that accounting standards used in the preparation of financial statements should be set in the private sector and not by legislation. Our concern is that accounting principles that are inconsistent with generally accepted accounting principles could erode public confidence in published financial reports. Such a loss of confidence may cause severe repercussions in our capital markets.

BACKGROUND

In the private sector, the Financial Accounting Standards Board (FASB) establishes standards for financial accounting and reporting. We acknowledge that Congress and regulatory agencies have the authority to set accounting standards for regulatory reporting purposes; however, we are concerned that differences between regulatory accounting principles (RAP) and generally accepted accounting principles (GAAP) could be confusing to the users of financial statements. Furthermore, past attempts to improve the financial conditions of troubled institutions by allowing the deferral and amortization of loan losses under RAP have failed to accomplish the desired objective and may have increased the potential loss.

The Comptroller General stated, in a letter to Congress, "The concern from accounting specialists over the use of RAP as a substitute for GAAP essentially comes down to this: RAP rules, where mandated, are almost always more lenient than generally accepted accounting principles. As such, they tend to disguise financial difficulties faced by regulated institutions, especially in the financial sector, thus depriving investors, depositors, regulators, insurers and others of critical information they need to make decisions." The Comptroller General recommended, "The tendency to move away from GAAP and to rely upon the more lenient standards of RAP is a practice that should be curbed. RAP promotes misleading public disclosure of important financial information and does not serve the best interests of regulators, the American taxpayer and the public at large. Indeed, in the long run, RAP rules do not even serve the best interests of regulated institutions."

Nonetheless, in the 100th Congress, various legislation has been introduced which includes language proposing accounting standards inconsistent with GAAP on issues ranging from banking to farming.

RECENT DEVELOPMENTS

None

POSITION OF OTHERS

The FASB, GAO, and the staff of the SEC generally oppose legislation establishing accounting standards that are inconsistent with GAAP.

JURISDICTION

Referral to a Congressional committee is determined by subject matter. For example, legislation regarding the Farm Credit System, which included accounting provisions, was referred to House and Senate agriculture committees. However, if legislation were introduced regarding oil and gas accounting, it would be referred to the House and Senate energy committees.

MAJOR FRAUD ACT OF 1988

ISSUE

Should Congress approve legislation which would create a new criminal offense of government contractor "procurement fraud"?

AICPA POSITION

The AICPA has not taken a formal position on legislation introduced by Representative Bill Hughes (D-NJ) and others.

BACKGROUND

In October 1987, Rep. Hughes introduced H.R. 3500, the "Major Fraud Act of 1987." This legislation, which was referred to the House Judiciary Crime Subcommittee chaired by Rep. Hughes, would create a new criminal offense of procurement fraud. Key provisions of the Hughes legislation are:

- criminal penalties are increased for persons defrauding or attempting to defraud the U.S. in "any procurement of property or services" if the consideration received for such goods or services is at least $1 million;
- convictions would be punishable by imprisonment for up to seven years, plus fines of up to double the amount of the contract;
- the current statute of limitations for contract fraud is extended from five to seven years; and
- individuals whose testimony lead to a procurement fraud conviction are allowed to share in a percentage of the fines levied against the contractor, up to a maximum of $250,000.

In February 1988 the Hughes Subcommittee reported revised substitute legislation, H.R. 3911, which included an amendment offered by Rep. Bill McCollum (R-FL). The McCollum amendment specifies that if a contractor is found guilty of committing procurement fraud he or she may be liable for double the contract value if the fraud "is substantial in relation to the value of such contract of services."

In March 1988, the Hughes Subcommittee held a hearing on the revised legislation. Industry groups, led by the U.S. Chamber of Commerce, testified that Congress should not pass H.R. 3911. The industry group witnesses unanimously opposed the legislation's "bounty" provisions which allow individuals whose testimony leads to a procurement fraud conviction to share in a percentage of the fines levied against the contractor, up to a maximum of $250,000.

The witnesses testified that these provisions will undermine contractors' self-governance and voluntary disclosure programs.

In April 1988, the subcommittee approved another revised bill that places a $10 million cap on fines that could be levied for a procurement fraud conviction. The subcommittee also limited the "bounty" provisions. Specifically, persons who could have prevented procurement fraud by disclosing their knowledge to their employer or who actively participated in the fraud would be barred from collecting the bounty.

The House Committee on the Judiciary approved H.R. 3911 on May 3, 1988. The legislation was passed by the House on May 10, 1988 by a vote of 419-0.

RECENT DEVELOPMENTS

In July 1988, the Senate Committee on the Judiciary held a hearing on H.R. 3911. In testimony, representatives from the Departments of Justice and Defense generally supported H.R. 3911. Some of the industry groups which testified before the Hughes Subcommittee opposing H.R. 3911 cited their same objections at this hearing.

In August 1988, the Senate Judiciary Committee adopted H.R. 3911 and the legislation is pending before the Senate. No date has yet been scheduled for Senate debate.

POSITION OF OTHERS

The U.S. Chamber of Commerce, the Professional Services Council, the Electronic Industries Association and the American Electronics Association are generally opposed to the provisions of H.R. 3911. **The Departments of Justice and Defense generally support H.R. 3911.**

JURISDICTION

SENATE - Committee on the Judiciary

HOUSE - Committee on the Judiciary

Crime Subcommittee

PROFESSIONALS' LIABILITY REFORM ACT OF 1988 (RITTER BILL)

ISSUE

Should Congress approve the Professionals' Liability Reform Act of 1988?

AICPA POSITION

The AICPA has not taken a formal position on legislation introduced by Representative Don Ritter (R-PA) and others.

BACKGROUND

In March 1988, Rep. Ritter introduced H.R. 4317, the "Professionals' Liability Reform Act of 1988." This legislation would establish uniform standards of liability for those who provide professional services. Provisions of the legislation include:

- o abolishing joint and several liability and establishing a several liability standard;
- o a privity requirement limiting the ability of third parties to bring suits;
- o a standard which requires that professional services be rendered negligent in order to find the professional liable;
- o periodic payments for damages rather than a single lump sum payment; and
- o limitations on punitive damage awards to plaintiffs.

H.R. 4317 was jointly referred to the House Energy and Commerce and Judiciary Committees. There is no companion legislation pending before the U.S. Senate at this time. No hearings are scheduled at this time.

RECENT DEVELOPMENTS

None

POSITION OF OTHERS

None identified at this time.

JURISDICTION

SENATE - Committee on the Judiciary

HOUSE - Committee on the Judiciary

Committee on Energy and Commerce

LONG TERM HEALTH/HOME CARE CATASTROPHIC LEGISLATION

ISSUE

Should Congress approve Long Term Health/Home Care Catastrophic legislation which would be funded by repealing the Medicare payroll tax cap?

AICPA POSITION

The AICPA has not taken a formal position on legislation introduced by Rules Committee Chairman Claude Pepper (D-FL). The AICPA opposed the procedure under which the Pepper Bill was brought to the House floor without proper utilization of the legislative process. We believe that further study was needed on the Pepper Bill and its proposed funding mechanism.

BACKGROUND

In October 1987, Rep. Pepper introduced H.R. 3436, the "Medicare Long Term Home Care Catastrophic Protection Act." The Pepper Bill, a multi-billion dollar entitlement program, would establish a long-term home-care benefit for the chronically ill or disabled of all ages. Little is known about the impact of the legislation because there was no opportunity for hearings. The cost was projected to be in excess of $30 billion over 5 years.

To fund the Pepper Bill, Congress would have repealed the cap on the wage base subject to the Hospital Insurance payroll tax for employers, self-employed individuals and employees. This repeal would increase both the employee and employer share of the payroll tax.

The current Hospital Insurance portion of the social security tax is approximately 3% on earnings up to $45,000 for 1988. The Pepper bill would uncap this ceiling and tax all salaries and self-employment income in excess of $45,000 an additional 3%.

On June 8, 1988 the House, through a procedural vote, defeated the rule that would have allowed additional consideration of the Pepper Bill. The vote was 243-169. Further consideration of the measure this year is not likely.

RECENT DEVELOPMENTS

In July 1988, Senator John Melcher (D-MT) proposed S. 2671, "Helping Expand Access to Long-Term Health Care Act of 1988," to provide funding for long-term health care. The Health Care Act would be financed through a combination of copayments and the elimination of the $45,000 cap on wages subject to the Medicare payroll tax. This measure was referred to the Senate Finance Committee. Hearings have not yet been scheduled.

In August 1988, Senator Edward Kennedy (D-MA) introduced S. 2681, the "Lifecare Long-Term Care Protection Act." Sen. Kennedy proposed that Lifecare be financed by increasing the current income ceiling on the payroll tax for both employees and employers. This is the same mechanism embodied in Rep. Pepper's legislation. S. 2681 has been referred to the Labor and Human Resources Committee, of which Sen. Kennedy is chairman. No action has been taken by the committee.

JURISDICTION

SENATE - Committee on Finance

Committee on Labor and Human Resources

HOUSE - Committee on Ways and Means

Committee on Energy and Commerce

THE FINANCIAL FRAUD DETECTION AND DISCLOSURE ACT (THE WYDEN BILL)

ISSUE

Should Congress approve the "Financial Fraud Detection and Disclosure Act?"

AICPA POSITION

The AICPA opposes such legislation for the following reasons:

- The responsibility for dealing with fraud and illegal acts, including the responsibility to report such matters to the appropriate regulators, is that of the company's board of directors and audit committee. The Wyden bill would inappropriately shift that responsibility to the independent auditor.

- The bill would substitute a system of governmental surveillance and supervision of corporate activities for that which has traditionally been exercised by corporate directors elected by the entities' shareholders.

- The bill would result in the forced enlistment of the accounting profession in the work of every federal, state, and local regulatory body and enforcement agency. This bill would convert the "public's watchdog" into the "government's bloodhound."

- The bill would actually diminish -- not increase -- the effectiveness of independent audits. A healthy professional skepticism is essential to the conduct of an audit. However, the Wyden bill would force the auditor into a direct adversary relationship with the company being examined, inhibiting frank communication necessary for an effective audit.

- The bill, if enacted, would add greatly to the costs of audits without apparent corresponding benefit.

BACKGROUND

During the 99th Congress, Representative Ron Wyden (D-OR) introduced H.R. 4886, "Financial Fraud Detection and Disclosure Act of 1986." The bill would have required, among other provisions, auditors of public companies to:

- Detect, without regard to materiality, any actual or suspected illegal or irregular activity by any director, officer, employee, agent, or other person associated with the audited entity.

- o Report publicly and to applicable federal, state, or local regulatory or enforcement agencies all instances of actual or suspected illegal or irregular activities.

- o Evaluate and report publicly on the audited entity's system of internal administrative and accounting controls.

A revised version of the Wyden bill was later introduced reflecting two major changes. First, it included the notion of materiality, although the bill's discussion of materiality was much broader than financial statement materiality. Second, the primary burden for reporting irregularities and illegal acts to enforcement and regulatory agencies was placed on the client. However, the auditor would still have independent reporting responsibilities that are inappropriate to the auditor's function. The 99th Congress did not take any action on the proposed legislation and it had not been reintroduced during the first session of the 100th Congress.

RECENT DEVELOPMENTS

The legislation has not been reintroduced in the current Congress.

POSITION OF OTHERS

Currently, there is little, if any, support for such legislation from the SEC, the GAO, and the business community.

JURISDICTION

SENATE - Committee on Banking, Housing and Urban Affairs

Securities Subcommittee

HOUSE - Committee on Energy and Commerce

Telecommunications and Finance Subcommittee

DISCLOSURE OF TAX RETURN INFORMATION (BYRON BILL)

ISSUE

Should tax return preparers be prohibited from transferring client information when selling their practice, without prior approval from the taxpayer?

AICPA POSITION

The AICPA Code of Professional Ethics does not specifically address the confidentiality of client tax return information where a "sale" of a practice has occurred. Although the AICPA has not taken a formal position on legislation introduced in Congress by Representative Beverly Byron (D-MD), we are in general agreement with the concept propounded by the bill.

BACKGROUND

In February 1987, Rep. Byron introduced legislation, H.R. 1196, intended to prohibit the transfer of returns and return information by tax return preparers in conjunction with the sale of their practice, unless the taxpayer consents to the transfer. We have recommended several changes to this legislation:

- Negative Consent -- H.R. 1196 requires the written consent of a taxpayer prior to transfer of tax related information in conjunction with a sale of the preparer's practice. We suggest that the legislation be amended so that when written notification of the transfer is provided to the taxpayer, the absence of a response by the taxpayer will be deemed consent to the transfer.

- Definition of "Sale" -- In order to eliminate confusion, we suggest that the term "sale" be defined so as not to include a business merger.

- Obligation to Secure Consent -- H.R. 1196 does not indicate who is responsible for securing the client's consent. We believe the bill should be amended to clearly state that the seller of the practice has the obligation and liability for notifying the taxpayer concerning the future sale.

- Penalties -- H.R. 1196 provides a criminal penalty of up to one year in prison and/or a fine of not more than $1,000 for a violation of the measure. We believe the imposition of a criminal sanction to be too harsh a penalty and suggest retaining only the fine portion of the penalty for a violation.

- Disclosure of Lists -- Current regulations under IRC 7216 provide that any tax return preparer may compile a list

containing the names and addresses of taxpayers whose returns he has prepared or processed, and may transfer that list without taxpayer consent, in conjunction with the sale or other disposition of the tax return business. As written, H.R. 1196 appears to prohibit the transfer or other disclosure of such a list absent consent by each client. We recommend that the legislation be amended to conform to current regulations.

Currently, there is no similar legislation in the U.S. Senate. Although H.R. 1196 was originally introduced with no co-sponsors, at present 32 representatives have become co-sponsors of the Byron bill. No hearings have been held on H.R. 1196.

POSITION OF OTHERS

None identified at this time.

JURISDICTION

SENATE - Committee on Finance

HOUSE - Committee on Ways and Means

SUMMARY OF AICPA OPERATIONS

- The AICPA is the national professional association of certified public accountants and is over 100 years old.

- Members are CPAs from every state, territory, or territorial possession of the United States and the District of Columbia.

- Currently, there are over 270,000 members. Approximately 46 percent of those members are in public practice, and the other 54 percent include members working in industry, education, government, and other various categories.

- The work of the AICPA is done primarily by its volunteer members serving on approximately 130 boards, committees, and subcommittees.

- The AICPA has a permanent staff of approximately 685 and a budget of $90 million.

- The AICPA Council is the association's policy-making governing body. Its 260 members represent every state and U.S territory. The Council meets twice a year.

- The Board of Directors acts as the executive committee of Council, directing Institute activities between Council meetings. The 21 member Board of Directors includes 3 public members, all of whom are lawyers and two are former SEC officials. The Board meets 5 times a year.

- Following are some of the major activities:

  - The AICPA promulgates technical standards in the areas of auditing standards, management advisory services, and accounting and review services.

  - The AICPA issues many publications for its members, such as journals, newsletters, and other services.

  - The AICPA has an extensive continuing professional education (CPE) program with over 400 course offerings. CPE is mandated in 48 states and territories and will be required for AICPA members beginning in 1990.

  - The AICPA has recently enacted a quality review program for all members in public practice.

  - The AICPA maintains a Washington office to represent the accounting profession and works with government officials in the legislative and executive branches of the federal government.